COLORADO CAPITAL GAIN SUBTRACTION

39-22-518

1) General Rule

- a) For tax years beginning on or after January 1, 1999 but prior to January 1, 2010, qualified taxpayers can subtract from the federal taxable income reported on their Colorado income tax return qualifying net capital gains on certain real, tangible and intangible property (pursuant to §39-22-518(2)(b), C.R.S.) acquired on or after May 9, 1994 and held for at least five years.
- b) For tax years beginning on or after January 1, 2010, qualified taxpayers can subtract from the federal taxable income reported on their Colorado income tax return up to \$100,000 of qualifying net capital gains on certain real and tangible personal property (pursuant to §39-22-518(2)(b), C.R.S.). Depending on the property generating the capital gain, the asset must have been acquired (1) on or after May 9, 1994 but prior to June 4, 2009, or (2) on or after June 4, 2009. The asset must be held for at least five years.
- 2) Expanded Subtractions. There were two expanded versions of the general rule for tax years in which State revenues exceeded limitations on state fiscal spending. These two expanded versions are:
 - a) **Subparagraph C and D**. Pursuant to §39-22-518(2)(b)(I)(C) and (D), C.R.S., the general rule was modified to eliminate the acquisition date requirement for tax years beginning on or after January 1, 1999 but prior to January 1, 2002.
 - b) **Subparagraph E and F**. Pursuant to §39-22-518(2)(b)(I)(E) and (F), C.R.S., the general rule was modified to reduce the holding period requirement to at least one year and eliminate the acquisition date requirement for tax years beginning on or after January 1, 2001 but prior to January 1, 2002.

3) Qualifying attributes

a) Installment sales

- i) The applicable holding period must be met as of the sale transaction date and cannot be met by referring to the date any deferred gain is recognized.
- ii) In cases in which the subtraction requirements applicable to the transaction year have been met, but the recognition of some or all of the gain is deferred to subsequent tax year(s), then the subtraction is allowed in the recognition year(s) for the deferred gain if the subtraction requirements applicable to the recognition year(s) were also met in the transaction year. Conversely, the subtraction will not be allowed in the recognition year(s) for deferred gain, if the deferred gain would not have met the subtraction requirements applicable to the transaction year. even though the deferred gain meets the subtraction requirements of the recognition year. Therefore, when the subtraction is allowed under either of the expanded subtraction rules because there are sufficient excess state revenues in the transaction year, and the recognition of some or all of the gain is deferred to subsequent tax year(s), a subtraction for such deferred gain is not allowed in the recognition year(s) if there are insufficient excess revenues in the recognition year(s) or the acquisition date and holding period requirements applicable to the recognition year were not met at the time of the transaction.

- b) "Pass-through" entities. A qualified taxpayer will be allowed to subtract qualifying gains passed through to the taxpayer by a partnership, S corporation, or other similar "pass-through" entity, if:
 - The pass-through entity holds the asset, and the taxpayer holds the ownership interest in the pass-through entity, for the required holding period (see paragraph g) below),
 - ii) The acquisition date is met by the pass-through entity (see paragraph g) below), and
 - iii) The asset that created the gain passed through to the taxpayer was either:
 - (1) 2010 and later real or tangible property that qualifies for the subtraction;
 - (2) 2009 and earlier (1) real or tangible personal property located in Colorado at the time of the transaction, or (2) a stock ownership interest in an entity that qualifies under §39-22-518(2)(b)(ii)(A), C.R.S. It is neither necessary nor sufficient for the pass-through entity itself to qualify under §39-22-518(2)(b)(ii)(A), C.R.S. in order to allow the subtraction for gains passed through to the taxpayer. However, gain from the sale of the partner's, S corporation stockholder's, or limited liability member's ownership interest in the pass-through entity will be allowed only if the pass-through entity qualifies under §39-22-518(2)(b)(ii)(A), C.R.S
- c) The taxpayer must hold the same interest for the required holding period. For example, a taxpayer who purchased a 50% interest in property on May 10, 1994, then acquires an additional 25% interest in the property on May 15, 1998, and subsequently sells the 75% interest on May 16, 1999, can subtract only the gain attributable to the 50% interest because the 25% interest did not meet the five-year holding period.
- d) In order to qualify under §39-22-518(2)(b)(ii)(A), C.R.S., the entity must have fifty percent or more of its property and fifty percent or more of its payroll assigned to locations within Colorado.
- e) Shell entities holding intangible property. When an entity has either no property or no payroll, or either such factor is de minimis in relation to the business operations of the entity, and the majority of the entity's value is attributable to stock or other ownership interests of other entities, then the Department will apply section 18 of the Multistate Tax Compact (§24-60-1301, et seq., C.R.S.) to evaluate whether the entity qualifies under §39-22-518(2)(b)(ii)(A), C.R.S.
- f) **Non-refundable/No carry forward**. This subtraction does not create a right to a refund or carry forward. Corporations must reduce any net operating losses created in tax years in which this subtraction is taken by the lesser of the subtraction allowed under this section or the amount of the net operating loss.
- g) **Property transfers between a pass-through entity and its members.** When determining the "qualified taxpayer" in the case of a pass-through entity, the taxpayer is considered to be the pass-through entity and the individual member in aggregate.
 - i) The acquisition date for determining the members' holding period of property that is transferred by a pass-through entity to its members is the date the passthrough entity acquired the property. This assumes the members owned their share of the entity for the entire period that the property was owned by the pass-

through entity. If any member acquired their share of the pass-through entity after the entity already owned the property, then the acquisition date of the property in the hands of the member would be the date they acquired their share of the entity.

- ii) The acquisition date for determining the members' holding period of property that is transferred by one member to a pass-through entity is, for the transferor, the date that member acquired the property, and, for all other members, the date of the transfer to the pass-through entity. This assumes the members owned their share of the entity for the entire period that the property was owned by the pass-through entity. If any member acquired their share of the pass-through entity after the entity already owned the property, then the acquisition date of the property in the hands of the member would be the date they acquired their share of the entity.
- iii) Example: Colorado property was acquired on May 1, 1994, by an individual, transferred to an S corporation on July 1, 1994, that is wholly owned by the individual, then sold by the S corporation on July 30, 1999. Therefore, the acquisition date of the asset is May 1, 1994. The holding period is May 1, 1994, through July 30, 1999. In this example the gain does not qualify as the property was acquired before May 9, 1994.
- iv) Example: Colorado property was acquired on October 1, 1999 by an LLC and distributed to its members on November 15, 2002. The acquisition date to be used for determining if the capital gain subtraction applies when a member sells the property is October 1, 1999.
- v) Example: Colorado property was acquired on June 1, 2002 by an individual. The property was transferred to a partnership in which the individual was a 40% partner on July 1, 2003. The property is sold on June 15, 2008 by the partnership. The individual's holding period for the property was from June 1, 2002 through June 15, 2008, which qualifies for the capital gain subtraction. However, the other partners' holding period for the property was from July 1, 2003 through June 15, 2008, which does not meet the five year holding period for the subtraction.
- vi) Example: Colorado property was acquired on June 1, 1992 by an individual. The property was transferred to a partnership in which the individual was a 40% partner on July 1, 2000. The property is sold on June 15, 2008 by the partnership. The individual's acquisition date for the property was June 1, 1992, which does not qualify for the capital gain subtraction. However, the other partners' acquisition date for the property was July 1, 2000, which does qualify for the subtraction.